



Kosovo Business Finance Fund



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RE: KBF Project Year-End Summary

The entire Bank staff are on the job on this New Year's Day to take care of the "triple-bang": D-Day for the Euro tomorrow; on-line with GLOBUS; and the Bank's year-end closing. Any one of these tasks, let alone all three at once, is a heavy load.

While the Bank is still in its infancy, the LPU activity is moving forward smoothly, having gotten past its growing pains of last summer and early fall. Local credit staff now make a strong contribution together with the expatriate managers.

So this is a good time for me to give my personal assessment of the high points, and disappointments, of the Project—Bank and LPU—as the New Year begins. Below is an assessment for (1) the Bank, (2) for the LPU, and (3) for the Project as a whole. The disappointments I express should be the focus of action to improve these areas during 2002. This summary is not intended to be an exhaustive review of all aspects of the Project.

I. American Bank of Kosovo

Achievements:

--The American Bank of Kosovo received, after strenuous efforts, its final operating license from BPK, and opened its doors for business, in November 2001.

--The deposit mobilization activity through December 31, 2001 has quickly surpassed the first-year Project benchmark target of DM 15 million. During 2001, over 4000 customer

accounts were opened, and representing deposits mobilized of more than DM 20 million.

--The Bank's application for Tier III status received the preliminary approval of BPK in December 2001, setting the stage for the Bank to enter the pension fund management business once the USAID-supported pension project is ready to launch.

--A strong strategic banking partnership is developing with Raiffeisenbank of Austria. This bank, with strong Balkan regional knowhow, is already providing efficient correspondent banking support to ABK. They are also developing a plan to introduce card services in Kosovo through ABK, and have the potential to take an interest in joining the capital structure of ABK at some future point.

--The KBF project, and ABK, took the initiative to spearhead the creation of the Association of Commercial Banks of Kosovo. On December 21, 2001, all seven licensed commercial banks in Kosovo signed a document agreeing to the establishment of this Association. ABK will serve on its Management Board, together with MEB and the New Bank of Kosovo. This Association has already engaged in a dialogue with BPK regarding the conditions of the Euro conversion. This Association is the first entity in Kosovo which groups both local and international financial institutions.

Disappointments:

--The RIAS/Rabobank support to the Bank, through its consultants and on-site management, was a major disappointment. Although RIAS entered into the Bank's initial share capital for a minimal amount (2.7 %), their core support tasks of installing bank systems, designing procedures, training local staff, and providing capable operating bank management were weak at best. The quality of the Rabobank correspondent banking support to ABK to date is also disappointing. .

--Staffing the Bank has been a difficult issue at all levels. The problems in the senior management team were largely overcome late in 2001, but there is a critical need to upgrade local staff skills in all functions, both by training and by selective hiring. Qualified, bank-trained Kosovars are rare, and a few key Kosovar staff should be sought and hired for the Bank from whatever source.

--The bank system (Globus, derived from Citibank systems), brought to the Bank by the RIAS/Rabobank systems consultant, had pre-operational technical problems which delayed its implementation. ABK then opened in November using an interim accounting system, approved by BPK in granting the final license but with clearly limited processing capacity. In late November Globus was re-installed, and the Bank's management has now succeeded in readying Globus to go "on line" starting January 2. But to do so successfully, all 2001 customer data for the more than 4000 new accounts (including almost 100 on December 31 alone) must be entered into Globus by Bank staff, while also being converted to Euros. This data entry for 2001 is now nearly complete (thanks to Bank staff working evenings, weekends and holidays including today). Because of the

critical importance of having an efficient accounting system to process a rising tide of customers and transactions, Bank management's top priority in the first few days of 2002 will not be to maximize new account opening (having already achieved the first year deposit target in one month), but to devote the maximum staff time possible during these days to having Globus operate on-line starting January 2 based on complete 2001 data entry and Euro conversion. To ease the public's pressure to open new bank accounts in the face of the Euro conversion, ABK has accepted BPK's recommendation to extend until January 15 the cutoff date (previously December 31) for customers to open new accounts with DM deposits with no charge for their conversion to Euros.

II. SME Lending (LPU) activity:

The DTTEM Six-Month Performance Assessment described the achievements of the SME lending operation. I will not repeat that but simply summarize current status:

Achievements:

--SME Loan Origination: As of year-end 2001, 87 loans have been approved by KBF and USAID, totaling DM 6,612,815. Disbursements of these loans total DM 3,448,815. The undisbursed amounts await completion of documentation and legal registration of collateral.

--Local Credit staff now total 15 professionals, who are performing and motivated. Credit and micro-lending training programs have been completed. A clear credit career path for local staff is being implemented: first assignment and training in Loan Origination; then a tour in Credit Administration; followed (subject to performance) by a higher-level position in Loan Origination, leading to Loan Officer designation replacing the current expat slots.

Disappointments:

--The pace of loan disbursements cannot follow the now-rapid pace of loan approvals because of the many impediments and gaps in the Kosovo legal environment. Registration of real property as collateral poses the greatest set of problems and delays. Also difficult is the persistent lack of proper corporate legal framework for incorporating business entities.

--Attracting and retaining expatriate Loan Officers with relevant experience combined with the ability to function effectively in the Kosovo and project environment has been a persistent problem.

--The heavy management needs of starting the Bank have required LPU staff resources to be redirected away from the LPU and to the Bank. This was required partly because the Bank's needs were underestimated originally, and partly to offset the weak RIAS

consultant and management support to the Bank. This circumstance has fortunately not prevented the LPU from achieving its positive level of performance.

III. The KBF Project overall:

Achievements:

--A workable legal vehicle--a local foundation/NGO, the Kosovo Business Finance Fund (KBFF)--was created by the Project at a very early stage. This entity and its structure has permitted the unusually trouble-free establishment of two distinct legal entities and activities in rapid succession: (1) the LPU activity, conducted through KBFF itself as lender; and (2) the Bank, of which KBFF is the founding (97.3 %) shareholder. The shareholder-friendly governance structure which was created for the Bank gives KBFF (and therefore DTTEM and USAID) effective control over the Bank, its Board of Directors and management. When the LPU activity integrates into the Bank, KBFF as controlling shareholder will be the vehicle for DTTEM and USAID to ensure proper functioning of the ongoing SME lending program operating within the Bank. KBFF will also be the vehicle for DTTEM and USAID to carry out the "exit strategy" and bring a strategic partner into the Bank's shareholding structure and management.

--The first step in integrating the LPU into the Bank (a 720-day benchmark target) has been taken, with the transfer on December 31, 2001 of a portion of the SME loan portfolio to the Bank. LPU staff has now joined the Bank in the same building. The stage is set to complete the integration of the LPU into the Bank during the first half of 2002, by taking the following steps: (1) reconstitution of the Credit Committee to include senior Bank managers (CEO Whittle in particular); and (2) full integration of SME lending unit into the Bank's organization; and (3) the transfer of the remainder of the LPU loan portfolio to the Bank.

--The Project succeeded in identifying suitable premises first for the LPU, and then for the Bank, now joined by the LPU. The challenges of finding suitable space in Pristina are great, and those of rendering any existing building suitable for the functional and security needs of a bank are still greater. The needed modifications were successfully achieved, overcoming a number of difficulties, and the Bank (with the LPU) is now housed in an attractive, centrally-located and well-secured premise.